Dynamic

STRATEGIES

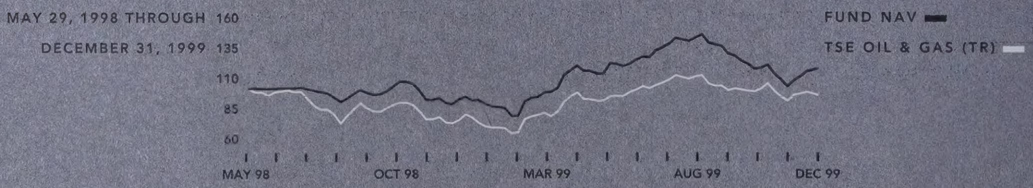
1999 ANNUAL REPORT | ARC STRATEGIC ENERGY FUND

THE FUND'S NET ASSET VALUE ("NAV") CLOSED THE YEAR AT $10.63 PER UNIT, AN INCREASE OF 26 PERCENT OVER THE PRIOR YEAR.

THE FUND'S NAV GAIN WAS ON PAR WITH THE TSE OIL & GAS INDICES FOR 1999. CUMULATIVE GAINS SINCE INCEPTION OF THE FUND WERE 15 PERCENT, COMPARED TO A FOUR PERCENT DECLINE IN THE TSE OIL & GAS TOTAL RETURN INDEX OVER THE CORRESPONDING PERIOD.

ON NOVEMBER 26, 1999, THE FUND'S A AND B UNITS WERE REDESIGNATED TO "TRUST UNITS," COINCIDING WITH THE ISSUANCE OF 4,436,000 WARRANTS TO UNITHOLDERS. THE WARRANTS ENTITLE THE HOLDERS TO PURCHASE 0.36813 UNITS PER WARRANT AT A PRICE OF $10.00 PER WHOLE UNIT UNTIL THEIR EXPIRY ON MARCH 31, 2000. THE WARRANTS TRADE ON THE TORONTO STOCK EXCHANGE UNDER THE SYMBOL AEF.WT.

RELATIVE PERFORMANCE SINCE INCEPTION



vision ARC STRATEGIC ENERGY FUND (THE "FUND") IS A GROWTH-ORIENTED ENERGY INVESTMENT FUND LAUNCHED IN THE SPRING OF 1998. THE FUND TRADES ON THE TORONTO STOCK EXCHANGE UNDER THE SYMBOL AEF.UN. THE FUND'S KEY OBJECTIVES ARE TO PROVIDE UNITHOLDERS WITH SUPERIOR RATES OF RETURN, PRIMARILY IN THE FORM OF CAPITAL GAINS, AND A COST-EFFECTIVE WAY TO REDUCE RISK THROUGH DIVERSIFICATION. THE FUND PROVIDES UNITHOLDERS WITH FOCUSED EXPOSURE TO HIGH UPSIDE AREAS OF THE CANADIAN OIL AND GAS SECTOR WHERE THE FUND MANAGER HAS UNIQUE EXPERTISE. ARC FINANCIAL CORPORATION ("ARC") IS THE ADVISOR AND ARC'S AFFILIATE, ARC ENERGY MANAGEMENT LTD., IS THE MANAGER OF THE FUND. ARC IS A SPECIALIZED INVESTMENT MANAGEMENT AND MERCHANT BANKING COMPANY FOCUSED SOLELY ON THE CANADIAN ENERGY SECTOR. THROUGH THE SUBSTANTIAL INVESTMENT OF ITS EMPLOYEES IN THE FUND AND A PERFORMANCE-BASED MANAGEMENT FEE STRUCTURE, ARC IS STRONGLY ALIGNED WITH UNITHOLDERS.

NOTICE OF ANNUAL MEETING: THE ANNUAL MEETING OF UNITHOLDERS WILL BE HELD ON THURSDAY, APRIL 27, 2000, AT 3:30 P.M. IN THE BRITANNIA ROOM AT THE WESTIN HOTEL, 320 – 4TH AVENUE S.W., CALGARY, ALBERTA.

long-term

VALUE

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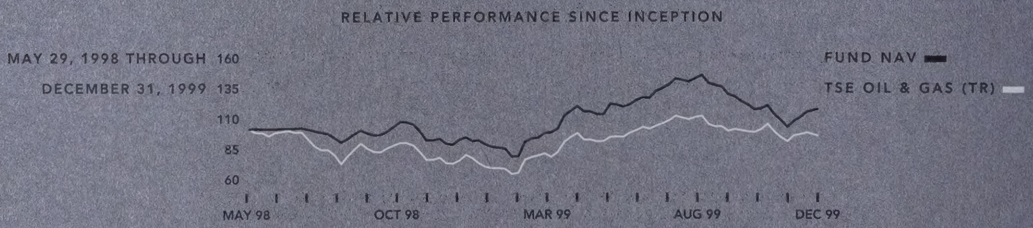

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VALUE

Highlights

($ thousands, except per unit)	Dec. 31, 1999	Dec. 31, 1998
Equity investments, at market value	68,811	52,555
Working capital	237	2,644
Bank loan	2,810	–
Net assets	66,238	55,199
Net asset value per unit – basic	$ 10.63	$ 8.45
Net asset value per unit – fully diluted	$ 10.50	$ 8.45
Units outstanding (thousands)	6,231	6,532

	Year ended Dec. 31, 1999	May 29, 1998 to Dec. 31, 1998
Realized gains on sale of investments	5,663	192
Unit price range (AEF.UN)		
High	11.00	10.50
Low	6.30	6.05
Close	8.25	6.20
Unit volumes traded (thousands)	702	249
Warrant price range (AEF.WT)		
High	0.50	–
Low	0.02	–
Close	0.06	–
Warrant volumes traded (thousands)	101	–

Top 10 Holdings

1. TESCO CORPORATION
2. PENN WEST PETROLEUM LTD.
3. TALISMAN ENERGY INC.
4. PETROMET RESOURCES LIMITED
5. COMPTON PETROLEUM CORPORATION
6. CANADIAN NATURAL RESOURCES LIMITED
7. RIO ALTO EXPLORATION LTD.
8. STARTECH ENERGY INC.
9. GENESIS EXPLORATION LTD.
10. ENCAL ENERGY LTD.

PORTFOLIO COMPOSITION

BY MARKET CAPITALIZATION

BY BUSINESS SECTOR

MAC H. VAN WIELINGEN
CHAIRMAN AND CHIEF EXECUTIVE OFFICER

KEVIN J. BROWN
PRESIDENT

Message to Shareholders

ARC STRATEGIC Energy Fund (the "Fund") is a growth-oriented investment fund focused on the Canadian oil and gas sector. The Fund was formed in the spring of 1998 with an initial public offering that raised net proceeds of $60.3 million or $9.23 per Unit (gross proceeds of $64.7 million or $9.90 per Unit). As such, 1999 represented its first full year of operation.

At the time of this writing, the Canadian oil and gas sector is enjoying one of, if not the most, attractive business environments we have ever seen due to the confluence of several factors, notably: strong oil and natural gas prices; rising demand and excess export capacity for both commodities; relatively narrow heavy oil differentials; and a weak Canadian dollar. As a result, the sector appears virtually assured of setting new record highs for cash flow generation and profitability this year. Balance sheets are generally strong, capital spending and drilling activity is returning to previous record highs and production growth should begin to accelerate as companies gain momentum with these larger programs.

Despite these positive fundamentals, the equity market for Canadian oil and gas companies has been weak for the past several months. While this poses near-term challenges, we are confident that the market will eventually recognize the exceptional value that now exists in both the sector and the Fund.

1999 IN REVIEW Nineteen ninety-nine was a year of unprecedented volatility and recovery for the Canadian oil and gas business. It began with oil prices in the midst of the most prolonged slump seen since OPEC became a major force in the early 1970s. Natural gas prices were also weak due to a second consecutive warmer-than-normal winter. As a result of these low commodity prices, Canadian oil and gas companies were under tremendous pressure. First quarter 1999 cash flows were up slightly from very depressed first quarter 1998 levels and 30 to 40 percent below first quarter 1997 levels, major write-downs were announced, balance sheets were stretched and capital spending was severely curtailed. Given this financial duress, Canadian oil and gas equities were also under pressure. The TSE Oil & Gas Index (the "Index") exited 1998 at 4,643, having lost 27 percent for the year, and continued to slide through the early part of 1999, bottoming at 3,598 on March 3, its lowest level since February 1995.

The business environment began to turn around in early March, with a 1.7 million barrel per day reduction in OPEC crude oil output. As the year progressed, the price impact of discipline by OPEC producers was reinforced by a large decline in non-OPEC crude oil supply and accelerating oil demand growth. The year ended with WTI prices averaging $US 26.00 per barrel in December, over twice the 1998 comparable. Canadian oil producers saw an even larger increase in their average oil realizations due to a concurrent narrowing in quality differentials, which led to even larger price increases for heavy oil during 1999.

The underlying tightness in the North American natural gas market also became increasingly apparent as the year progressed. By the end of summer, Henry Hub spot prices were approaching $US 3.00 per million BTU, while Alberta spot natural gas prices were well above the $3.00 per thousand cubic foot level. Prices backed off late in the year, but remained relatively strong considering that both November and December were much warmer than normal.

Driven by these higher commodity prices, the sector's financial performance showed dramatic improvement through the year, culminating with fourth quarter cash flow generation establishing new record highs. Equity markets were quick to reward this improvement. From its bottom, the Index showed a 74 percent gain to a peak of 6,908 in early September. At that time, the performance of oil and gas equities took a distinct turn for the worse with the Index sliding

to 5,862 by year-end. While this represented a gain of 27 percent for the year, the closing level was still 27 percent below the all time high of 8,302 established in October 1997 in an environment where commodity prices were approximately 30 percent below year-end 1999 levels.

OUTLOOK Looking forward, we are very encouraged by the outlook for commodity prices. WTI crude oil prices have been trading in the $US 25.00 to 30.00 per barrel range since November 1999; and January's average of $US 27.30 per barrel was the highest monthly average since the peak of the Gulf war in September-November 1990. While oil prices could come under some pressure in the near term, downside risk appears modest as the world oil market is operating with a very tight supply-demand balance. Based on economic fundamentals, we continue to believe that $US 20.00 per barrel represents a reasonable long-term target level for WTI prices. However, given the current tightness in oil markets, prices have a very good chance to exceed this level through the balance of 2000 and well into 2001.

Natural gas also has a very positive outlook as all evidence continues to point to a tightly balanced North American market. Despite another warm winter, Henry Hub and Alberta spot prices are both up 20 to 25 percent from year-ago levels. Production in both Canada and the U.S. is showing little or no signs of growth despite robust levels of drilling activity. Demand, on the other hand, has significant growth potential, particularly in the electric generation sector where gas is well positioned to capture market share by virtue of its superior environmental qualities, low capital costs and the modular nature of gas-fired facilities. For Canadian natural gas producers, the outlook is uniquely attractive as recent pipeline expansions and the start-up of the Alliance pipeline system later this year provide ample access to an expanding U.S. market, and the basis for both higher prices and volume growth.

Despite the attractive commodity outlook, oil and gas equities remain weak. At February 14, 2000 the Index was at 5,835, roughly the same as its year-end level. At this level, Canadian oil and gas companies are trading, on average, at record low cash flow multiples based on WTI price expectations of $US 21.50 and $US 20.00 per barrel for 2000 and 2001, respectively. If equities were trading anywhere near historical multiples, the Index would be 25 to 35 percent above its current level.

It is our view that the recent poor performance of oil and gas equities is primarily the result of a major withdrawal of capital from the sector. Marginal investment dollars are being diverted to higher return foreign markets and, more visibly, to the incredibly hot technology sector. To put this shifting flow of capital into perspective, Nortel and BCE comprised roughly 12 percent of the TSE 300 Index at the beginning of 1999. By year-end, these two stocks had an index weighting of 28 percent, having accounted for roughly 75 percent of the broad market's 30 percent yearly gain. To maintain market weighting in their portfolios, financial institutions are being forced to sell off large holdings in other sectors. Oil and gas stocks have absorbed much of this selling pressure as their gains over the past year represented a major source for profit taking.

FUND PERFORMANCE Outperforming the total return version of the Index on a net asset value ("NAV") basis is a key objective for the Fund. We fell just short of this objective in 1999, as the Fund's NAV gained 26 percent for the year to a closing level of $10.63 per Unit (basic), compared to a 27 percent change in the Index on a total return basis. All of the under-performance occurred in the fourth quarter, during which the Fund's NAV declined 14 percent versus a six percent drop in the Index. Roughly half the under-performance was attributable to investments in Merit Energy Ltd. and Badger Daylighting Inc. Detailed reviews of these two situations have been made and hard lessons have been learned which we believe will reduce the risk of similar experiences in the future. The Fund's weighting towards smaller capitalization gas-levered companies also negatively impacted fourth quarter 1999 performance.

Looking forward, we remain committed to a long-term strategy of focusing a significant portion of the Fund's portfolio on smaller capitalization companies with quality management teams and superior growth potential. In our view, investment fundamentals remain positive and, if anything, have improved for such companies given the withdrawal of several major companies from conventional Western Canadian activities. This withdrawal is increasing the supply of assets for sale, creating joint-venture and farm-in opportunities and will lower levels of competition. We also intend to maintain our bias towards natural gas based on the positive long-term outlook for prices and the exploration potential that exists in Western Canada. While we will maintain a long-term orientation in our investment activities, we also plan to more aggressively capitalize on short-term trading opportunities created by market volatility.

At year-end 1999, the Fund's equity investments had a total value of $69.1 million, of which 94 percent was invested in growth and early stage companies, with the balance allocated to turnaround situations. Approximately 88 percent of the portfolio was invested in companies with less than $1.5 billion in market capitalization.

A truly unique feature of the Fund is its investment in early stage companies with less than $100 million in market capitalization. The Fund's exposure to such companies, which comprised 23 percent of the portfolio at year-end, is provided through investment in the ARC Canadian Energy Venture Funds (the "Venture Funds"), which are managed by affiliates of the Fund Manager. In total, the Fund has committed $22.5 million to the Venture Funds on the same terms as a group of large financial institutions. The Venture Funds' strategy includes being supportive and involved long-term investors, and, in this regard, officers of ARC currently serve as directors on the boards of 15 investee companies.

A significant issue facing the Fund is the fact that its Units, which are listed on the Toronto Stock Exchange, have been trading at a discount to the Fund's underlying NAV. During 1999, the Unit price traded at an average discount to NAV of 15 percent, and closed the year at a 22 percent discount. While this discount is a concern, particularly to those unitholders that participated in the Fund's initial public offering, it should be noted that virtually all closed end funds in North America face this issue.

The Fund has taken steps to support its Unit price and provide unitholders with additional liquidity. Such steps include the implementation of a mandatory buy-back program on January 1, 1999 and a Normal Course Issuer Bid that was put in place on October 13, 1999. The Fund has been aggressively implementing these initiatives and we remain committed to exploring all available alternatives to narrow the discount.

It is important to recognize that the closed end structure also offers some unique advantages to long-term investors. Most importantly, it provides a stable pool of capital, which is a prerequisite for the Fund's long-term investment strategy of focusing on high growth, smaller capitalization companies that often have poor liquidity attributes. Such stability allows us to maintain this strategy in a declining market, as we are not forced to sell securities to fund redemptions, and it imposes discipline in a rising market, as we will not experience substantial inflows of new capital that must be invested at higher prices.

Our objective in creating the Fund in May of 1998 was to provide our unitholders with superior relative performance and attractive absolute returns. We will deliver on these objectives or steps will be taken to restructure or wind down the Fund well before its 10-year term expires. In this connection, we note that employees and independent directors have approximately $3.5 million invested in the Fund, which is an unusually high commitment in the context of managed capital in Canada. From the outset, we structured the Fund, and established our commitments to the Fund, in a manner that was consistent with the interests of our investors.

In closing, we have never seen a more attractive business environment for the Canadian oil and gas sector. While the attention of the equity market is elsewhere at this point in time, we firmly believe that the fundamental value offered by the Canadian oil and gas sector and this Fund will eventually be recognized.

Respectfully submitted on behalf of the Fund by its Manager, ARC Energy Management Ltd.

M Van Wielingen

MAC H. VAN WIELINGEN

CHAIRMAN AND CHIEF EXECUTIVE OFFICER

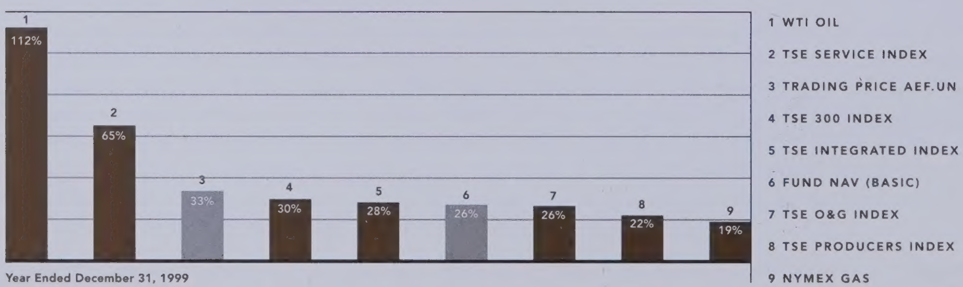
Kevin Brown

KEVIN J. BROWN

PRESIDENT

The manager OF THE FUND HAS EXTENSIVE FINANCIAL AND TECHNICAL EXPERIENCE TO ORIGINATE AND MANAGE INVESTMENTS IN THE OIL AND GAS SECTOR. THE FUND DRAWS ON THE EXPERTISE ARC HAS ESTABLISHED IN ALL AREAS OF ITS BUSINESS: INVESTMENT RESEARCH, SMALL CAP EQUITY INVESTING, CORPORATE ADVISORY AND MERCHANT BANKING, AND OIL AND GAS PRODUCTION MANAGEMENT.

VARIOUS INDICES VS. FUND PERFORMANCE



BACKGROUND ARC STRATEGIC Energy Fund (the "Fund") was formed in the spring of 1998. ARC Energy Management Ltd. (the "Fund Manager") is the direct manager of the Fund. The Fund's investments in early stage companies (market capitalization less than $100 million) are managed by the ARC Canadian Energy Venture Funds (the "Venture Funds"), which are private investment funds managed by affiliates of the Fund Manager (the "Venture Fund Managers").

FUND PERFORMANCE At December 31, 1999, the net asset value ("NAV") of the Fund stood at $66.2 million or $10.63 per Unit, an increase of 26 percent over the closing NAV of the prior year. During the year, the NAV per Unit fluctuated from a low of $7.24 to a high of $13.15. The 1999 NAV gain was only marginally below the 27 percent advance in the Fund's benchmark, the TSE Oil & Gas Total Return Index (the "Index"). After outperforming the Index by 10 percent for the first nine months of the year, the Fund's performance lagged the Index during the fourth quarter, largely due to poor performance of the Fund's investments in early stage, natural gas levered equities as well as in the highly publicized Merit Energy Ltd. failure. Since its inception in May 1998, the NAV of the Fund gained 15 percent compared to a four percent loss by the Index.

	Dec. 31/99 Value	Returns Inception	1999	Q4/99
Fund NAV/Unit (Basic)	$ 10.63	15%	26%	(14%)
Fund NAV/Unit (Fully Diluted)	$ 10.50	14%	24%	(11%)
Trading Price (Symbol AEF.UN)	$ 8.25	(14%)	33%	(17%)
TSE O&G Index	5,862	(5%)	26%	(6%)
TSE O&G Index (Total Return)	7,878	(4%)	27%	(6%)

UNIT PERFORMANCE AND TRADING DISCOUNT The Fund's Units trade on the Toronto Stock Exchange (the "TSE") under the symbol AEF.UN. Daily closing trading prices ranged from $6.30 to $11.00. The December 31, 1999 closing price was $8.25, representing a 33 percent gain for the year.

The total volume of Units traded during 1999 was 702,000, corresponding to an average daily trading volume of 2,820 Units. The relatively low trading volumes reflect the fact that prior to November 25, 1999, the Fund's Units were comprised of Class A Units and Class B Units with Class A Units carrying an entitlement to receive warrants. Any Class A Units sold prior to November 25th converted to Class B Units and lost the warrant entitlement. On November 25th there were 4,435,948 Class A Units and 1,869,352 Class B Units outstanding, all of which were redesignated to the same class of Trust Units. At year end, there were a total of 6,231,000 Units outstanding.

Throughout the year the Unit price discount to NAV ranged from three percent to 26 percent, averaging 15 percent for the year and closing at a 22 percent discount. The trading price discount to NAV is a significant concern to the Fund Manager. To provide additional price support and liquidity to unitholders, the Fund commenced a mandatory market repurchase program (the "Buy-Back Plan") on January 1, 1999, under which the Fund is using its best efforts to purchase Units for cancellation which are offered for sale on the TSE at prices less than 92.5 percent of the weekly NAV per Unit. Repurchases under the Buy-Back Plan are limited to a maximum of 1.25 percent of the issued and outstanding Units per quarter. There were 251,100 Units purchased and cancelled under the Buy-Back Plan during the year at an average price of $8.96 per Unit for a total cost of $2.3 million.

The Fund also launched a Normal Course Issuer Bid (the "Issuer Bid") on October 13, 1999 whereby it may purchase a maximum of 596,000 Units for cancellation until October 12, 2000. There were 50,400 Units purchased and cancelled under the Issuer Bid at an average price of $8.34 per Unit during the year.

As the trading price discount has persisted despite the implementation of these programs, the Fund Manager is committed to implementing strategies which will reduce the discount and is considering various alternatives to resolve this issue.

OPERATING ACTIVITIES The Fund's earnings are substantially derived from gains on the sale of portfolio investments, with a small proportion from interest and dividends. During the year, the Fund realized gains of $5.7 million on the sale of investments with an original cost of $23.8 million, representing an average return on investment of 24 percent on these investments. Interest income for the year of $145,000 was significantly down from the 1998 level of $894,000, reflecting the fact that the Fund was substantially fully invested in equity securities during the year. After deducting $2.8 million of Fund expenses, net realized earnings of the Fund during the year were $3.1 million or $0.49 per Unit.

MANAGEMENT FEES AND EXPENSES Basic management fees and general and administrative charges paid by the Fund translate into a management expense ratio ("MER") of 2.4 percent of weighted average net assets. The MER is comparable to the prior year and compares favourably to other specialized investment funds. Management fees are paid to either the Fund Manager or the Venture Fund Managers. Each fee is calculated based only on the portion of investments under the direct control of the respective manager. Therefore there is no duplication of fees.

In the second and third quarters, the Fund also paid a total of $1.0 million to the Fund Manager pursuant to the Fund Manager's incentive fee which is payable quarterly when the portion of the investment portfolio managed directly by the Fund Manager generates returns that exceed the Index. The excess return compared to the Index was 3.8 percent and 6.7 percent in the second and third quarters, respectively. The poor fourth quarter performance of the Fund resulted in a credit against the Fund Manager's incentive fee of $1.2 million which will be carried forward and offset against future incentive fees earned until the shortfall is eliminated.

The Venture Fund Managers also have an option which essentially allows them to receive 20 percent of the cumulative gains of the assets in the Venture Funds provided a threshold 7 percent annual return is realized. There were no amounts realized under the option during the year, but the accrued value under the option of $696,000 has been deducted from the value of the Fund's portfolio investments.

PORTFOLIO HOLDINGS The Fund had net unrealized gains in the investment portfolio of $6.9 million at year-end based on the following investment classifications:

($ millions)	Average Cost	Market Value	% of Portfolio	Unrealized Gain (Loss)	% Change
Growth	39.7	48.8	71%	9.1	23%
Turnaround	7.8	4.1	6%	(3.7)	(47%)
Early Stage	14.7	16.2	23%	1.5	10%
Total Equity	62.2	69.1	100%	6.9	11%

Investments in "growth" and "early-stage" companies represented 94 percent of the portfolio, reflecting the Fund's continued long-term strategy which focuses on companies with above average value growth potential. This strategy is also reflected in the Fund's holdings, classified by market capitalization, with 55 percent of the Fund invested in "early stage" and "junior companies." The Fund is actively involved in many of the early-stage investments through the Venture Funds, where directors and officers of ARC Financial Corporation serve as directors on the boards of 15 investee companies.

Category	Production*	Market Capitalization*	% of Portfolio	% Increase Over Cost
Early Stage	(<5 mboe/day)	Less than $100 million	23%	10%
Junior	(5 – 15 mboe/day)	$100 million to $350 million	32%	1%
Intermediate	(15 – 70 mboe/day)	$350 million to $1.5 billion	33%	24%
Senior	(>70 mboe/day)	> $1.5 billion	12%	9%
Total			100%	11%

* Production is used to categorize investments. Market capitalization ranges are indicative and can change significantly depending on share prices.
Mboe = thousand barrels of oil equivalent.

From a business sector perspective, 78 percent of the Fund's equity investments were exploration and production companies ("E&P"), with the balance invested in the oilfield service sector. The Fund's E&P investments were slightly biased towards natural gas, accounting for approximately 53 percent of the barrel of oil equivalent ("boe") production represented by such ownership, compared to natural gas representing 38 percent of total Canadian boe production.

CAPITAL RESOURCES The Fund had cash of $501,000 at December 31, 1999 with an outstanding commitment to the ARC Canadian Energy Venture Fund 2 of $2.6 million. The commitment will be called by the Venture Fund manager from time to time prior to October 15, 2002. The Fund also has a $10 million demand credit facility with a Canadian chartered bank, of which $2.8 million was drawn at year-end.

WARRANTS At December 31, 1999, there were 4,436,000 warrants issued and outstanding, entitling the holders to acquire 0.36813 Units per warrant at a price of $10.00 per whole Unit prior to March 31, 2000. A portion of the proceeds from warrants exercised will be used to increase the Fund's exposure to early-stage companies through an additional investment in the Venture Funds.

YEAR 2000 To date, the Fund has not experienced problems or interruptions due to the year 2000 issue. Minimal costs were incurred to prepare for the year 2000 and no additional costs are expected.


OPTION VALUATION MATRIX

Management's Responsibility

ARC Energy Management Ltd. (the "Manager"), as manager of ARC STRATEGIC Energy Fund (the "Fund") is responsible for the preparation of the accompanying financial statements and for the consistency therewith of all other financial and operating data presented in this annual report. The statements have been prepared in accordance with the accounting policies detailed in the accounting policies note to the financial statements. In the Manager's opinion, the financial statements are in accordance with generally accepted accounting principles, have been prepared with acceptable limits of materiality, and have utilized supportable reasonable estimates.

Management maintains a system of internal controls to provide reasonable assurance that all assets are safeguarded, transactions are appropriately authorized and to facilitate the preparation of relevant, reliable and timely information.

Arthur Andersen LLP, independent auditors, appointed by the Manager, have examined the financial statements of the Fund. The Audit Committee, consisting of two independent directors and one director, who is an officer of the Manager, has reviewed these statements with management and the auditors, and has recommended their approval to the Board of Directors of the Manager. The Board has approved the financial statements on behalf of the Trust.

KEVIN J. BROWN

PRESIDENT & DIRECTOR

NANCY L. SMITH

VICE-PRESIDENT FINANCE & CFO

Calgary, Alberta.

February 9, 2000.

Auditors' Report

TO THE UNITHOLDERS OF ARC STRATEGIC ENERGY FUND:

We have audited the statement of net assets of ARC STRATEGIC Energy Fund as at December 31, 1999 and 1998, and the statements of operations, changes in net assets and financial highlights for the periods then ended and the statement of portfolio investments as at December 31, 1999. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards in Canada. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 1999 and 1998 and the results of its operations, the changes in its net assets and financial highlights for the periods then ended in accordance with generally accepted accounting principles in Canada.

Arthur Andersen LLP

CHARTERED ACCOUNTANTS

Calgary, Alberta.

February 9, 2000.

Statement of Net Assets

As at December 31
($ thousands, except per unit)

	1999	1998
ASSETS		
(Note 7)		
Investments, at market value (Notes 2 and 6)	$ 68,811	$ 52,555
Cash and short-term investments	501	4,049
Other assets	16	–
Total Assets	69,328	56,604
LIABILITIES		
Accounts payable and accrued liabilities (Notes 4 and 5)	280	1,405
Bank loan (Note 7)	2,810	–
Total Liabilities	3,090	1,405
Net Assets	$ 66,238	$ 55,199
Units Outstanding (thousands) (Note 3)	6,231	6,532
Net Asset Value Per Unit (Note 3)	$ 10.63	$ 8.45
Fully Diluted Net Asset Value Per Unit (Note 3)	$ 10.50	$ 8.45

Approved on behalf of the Board:

M VanWielingen

DIRECTOR

DIRECTOR

Statement of Operations

For the Periods Ended December 31
($ thousands, except per unit)

	1999	1998
INCOME		
Interest income	$ 145	$ 894
Dividend income	89	–
	234	894
EXPENSES		
Management fees (Note 4)	864	524
Incentive fees (Note 4)	1,047	823
General and administrative (Note 5)	312	141
Professional fees	153	28
Custodian fees	72	12
Interest expense	60	–
Unitholder communication	53	50
Directors fees	38	18
Goods and Services Tax	171	105
	2,770	1,701
Net Investment Income (Loss)	(2,536)	(807)
Net Realized Gain on Sale of Investments (Note 6)	5,663	192
Net Unrealized Gain (Loss) on Investments (Note 6)	10,587	(4,485)
Increase (Decrease) in Net Assets from Operations	$ 13,714	$ (5,100)
Increase (Decrease) in Net Asset Value Per Unit (Note 3)	$ 2.13	$ (0.78)
Fully Diluted Increase (Decrease) in Net Asset Value Per Unit	$ 2.06	$ (0.78)

The accompanying notes are an integral part of these financial statements.

Statement of Changes in Net Assets

For the Periods Ended December 31 ($ thousands)	1999	1998
Increase (Decrease) in Net Assets from Operations	$ 13,714	$ (5,100)
Unitholder Transactions		
Repurchase of Units (Note 3)	(2,675)	–
Net proceeds from Units issued (Note 3)	–	60,299
Increase in Net Assets	11,039	55,199
Net Assets, Beginning of Period	55,199	–
Net Assets, End of Period	$ 66,238	$ 55,199

Statement of Financial Highlights

For the Periods Ended December 31 (All data is per unit, except as otherwise noted)	1999	1998
Net Asset Value, Beginning of Period	$ 8.45	$ –
Income (Loss) from Investment Operations:		
Net investment income (loss)	(0.39)	(0.12)
Net realized gain on sale of investments	0.88	0.03
Net unrealized gain (loss) on investments	1.65	(0.69)
	10.59	(0.78)
Repurchase of Units (Note 3)	0.04	–
Net Proceeds from Units Issued	–	9.23
Net Asset Value, End of Period	$ 10.63	$ 8.45
Net Assets, End of Period ($ thousands)	$ 66,238	$ 55,199
Weighted Average Net Assets(1) ($ thousands)	$ 67,658	$ 58,114

(1) Based on all published weekly net asset values during the period

The accompanying notes are an integral part of these financial statements.

As at December 31, 1999 ($ thousands)	Number of Shares (thousands)	Cost	Market Value	% of Portfolio
PUBLIC EQUITIES:				
Tesco Corporation	493	$ 3,996	$ 4,537	6.55%
Penn West Petroleum Ltd.	145	2,370	4,099	5.91%
Talisman Energy Inc.	105	4,305	3,878	5.60%
Petromet Resources Limited	868	2,799	3,689	5.32%
Compton Petroleum Corporation	1,523	2,706	3,655	5.27%
Canadian Natural Resources Limited	98	2,343	3,447	4.97%
Rio Alto Exploration Ltd.	164	3,274	3,352	4.84%
Startech Energy Inc.	500	2,375	3,300	4.76%
Genesis Exploration Ltd.	351	2,055	3,247	4.68%
Encal Energy Ltd.	478	2,627	3,154	4.55%
Berkley Petroleum Corp.	248	2,576	3,132	4.52%
Ensign Resource Service Group	68	877	2,281	3.29%
Badger Daylighting Inc.	422	2,310	1,667	2.40%
Beau Canada Exploration Ltd.	928	1,678	1,577	2.27%
Stellarton Energy Corporation	451	925	1,555	2.24%
Tethys Energy Inc.	798	1,526	1,334	1.92%
Ionic Energy Inc.	389	870	1,265	1.83%
Bonus Resource Services Corp.	520	1,489	1,223	1.76%
NQL Drilling Tools Inc.	165	1,005	1,157	1.67%
Gulfstream Resources Canada Limited	399	1,204	1,037	1.50%
Thunder Energy Inc.	483	825	967	1.39%
Newport Petroleum Corporation	278	1,200	918	1.32%
Peak Energy Services Ltd.	371	989	723	1.04%
Petrobank Energy and Resources Ltd.	375	777	615	0.89%
Edge Energy Inc.	217	660	608	0.88%
Merit Energy Ltd.	807	3,719	605	0.87%
Gauntlet Energy Corporation	562	562	568	0.82%
Corlac Oilfield Leasing Ltd.	597	328	567	0.82%
Ventus Energy Ltd.	85	599	563	0.81%
TriQuest Energy Corporation	859	430	516	0.74%
Real Resources Inc.	970	834	407	0.59%
Sunfire Energy Corporation	189	189	371	0.54%
Pulse Data Inc.	414	382	291	0.42%
Other Public		1,978	2,099	3.03%
		56,782	62,404	90.01%
PRIVATE EQUITIES:				
Avalanche Energy Ltd.	720	1,073	2,882	4.17%
Passage Energy Inc.	1,963	1,444	1,570	2.27%
Western Oil Sands Inc.	85	638	638	0.92%
Other Private		2,219	1,565	2.26%
		5,374	6,655	9.62%
TOTAL EQUITY INVESTMENTS		62,156	69,059	99.63%
OPTIONS AND FUTURES		553	448	0.65%
UNREALIZED VENTURE FUND MANAGERS' OPTION (NOTE 6)		–	(696)	(1.00%)
		62,709	68,811	99.28%
CASH AND SHORT-TERM INVESTMENTS		501	501	0.72%
TOTAL PORTFOLIO INVESTMENTS		$ 63,210	$ 69,312	100.00%

The accompanying notes are an integral part of these financial statements.

December 31, 1999 and 1998

1. Structure of the Fund

ARC STRATEGIC Energy Fund (the "Fund") is a closed-end investment trust established under the laws of the Province of Alberta pursuant to a Declaration of Trust dated April 9, 1998, as amended and restated between the Fund and Montreal Trust Company of Canada (the "Trustee"). The Fund is managed by ARC Energy Management Ltd. (the "Fund Manager"), and effectively commenced operations on May 29, 1998, concurrent with the closing of its initial public offering.

The Fund invests in various opportunities within the Canadian energy sector, subject to certain restrictions on the maximum proportion of the Fund which can be invested in specific types of securities.

A portion of the Fund's investments are made and beneficially held through the ARC Canadian Energy Venture Fund ("Venture Fund 1") and ARC Canadian Energy Venture Fund 2 ("Venture Fund 2") (collectively, the "Venture Funds"), private joint investment funds managed by companies under common control with the Fund Manager (the "Venture Fund Managers"). The Fund's beneficial interests in the net assets and results of operations from the Venture Funds are included in these financial statements.

2. Summary of Significant Accounting Policies

These financial statements have been prepared in accordance with generally accepted accounting principles in Canada. The preparation of financial statements requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the reporting period. Actual results could differ from those estimated. The following significant accounting policies are followed by the Fund.

VALUATION OF INVESTMENTS Investments are presented at market value. Securities listed on a stock exchange are valued at the last quoted sale price on the principal exchange where they are traded, or if no such price is available, at the closing quoted price or the average of the bid and ask price, if available. Securities which are not listed on a stock exchange are valued in good faith by the Fund Manager in accordance with fair value policies and procedures established by the Fund Manager and accordingly are subject to measurement uncertainty. Investments at December 31, 1999, include securities valued at $6,655,000 (original cost of $5,374,000) which are not listed on a stock exchange and have been valued in accordance with these procedures (1998 – $2,508,000 and $2,130,000, respectively). The market value of call option contracts is the last quoted ask price for short positions and the last quoted bid for long positions.

INVESTMENT TRANSACTIONS AND INCOME RECOGNITION Investment transactions are recorded on the trade date. Realized and unrealized gains and losses on investments are determined using the average cost basis. Premiums received from or paid for call options are included in investments and marked to market with the difference recorded as part of unrealized gain (loss) on investments in the Statement of Operations. Other income from investments is recognized when it is earned.

INCOME TAXES The Fund currently qualifies as a mutual fund trust under the *Income Tax Act* (Canada), and accordingly, is not liable for tax on the portion of its taxable income that is paid or allocated to unitholders. The Fund distributes all taxable income to unitholders in each taxation year, and consequently no provision for income taxes is included in the Fund's financial statements. Distributions paid and payable to unitholders are to be included in the calculation of the unitholder's taxable income for any particular year. There was no taxable income for the Fund and no distributions paid or payable to unitholders for the periods ended December 31, 1999 and 1998.

TRUST UNIT INCENTIVE PLAN The Fund has a Trust Unit Incentive Plan (the "Incentive Plan") for the independent directors of the Fund Manager which is described in Note 3. No compensation expense is recognized when Trust Unit options are issued. Consideration paid by option holders on exercise of Trust Unit options is accounted for as an increase in net assets.

3. Unitholder Transactions

The authorized capital of the Fund consists of an unlimited number of transferable non-redeemable Trust Units each of which has an equal beneficial interest in the net assets, net earnings and distributions of the Fund. During 1999, all Class A and B Trust Units were redesignated to Trust Units.

UNITS ISSUED AND OUTSTANDING:

(thousands)	Number	Amount
Balance, April 9, 1998	–	$ –
Initial public offering	6,319	62,622
Over allotment	213	2,045
Issuance costs	–	(4,368)
Balance, December 31, 1998	6,532	$ 60,299
Cancelled under mandatory buy-back	(251)	(2,255)
Cancelled under issuer bid	(50)	(420)
Balance, December 31, 1999	6,231	$ 57,624

The Fund has a mandatory buy-back plan (the "Buy-Back Plan") under which it is required to purchase Trust Units offered for sale through the facilities of the Toronto Stock Exchange (the "Exchange") at prices less than 92.5 percent of the weekly net asset value ("NAV") per Trust Unit to a maximum of 1.25 percent of the issued and outstanding Trust Units per quarter.

The Fund also has a Normal Course Issuer Bid (the "Issuer Bid") under which it may purchase a maximum of 596,000 Trust Units through the Exchange at market prices not exceeding the weekly NAV per Trust Unit. The Issuer Bid will expire on October 12, 2000. All Trust Units purchased under the Buy-Back Plan and Issuer Bid are immediately cancelled.

During 1999, there were 4,436,000 warrants issued to the former Class A unitholders pursuant to the terms of the Fund's initial public offering. All warrants remained outstanding as at December 31, 1999. The warrants entitle the holder to purchase 0.36813 Trust Units per warrant at a price of $10.00 per whole Trust Unit and expire on March 31, 2000. The warrants were not ascribed any value at the date of issue.

A maximum 400,000 Trust Units may be issued under the Fund's Incentive Plan. Options to purchase an aggregate of 100,000 Trust Units at an exercise price of $9.60 per Trust Unit have been granted under the Incentive Plan. One-third of the options were vested as at December 31, 1999 (1998 – NIL) with the remaining vesting equally on each of May 29, 2000 and 2001. The options are exercisable until May 29, 2005. No options were granted, exercised or cancelled during 1999.

The NAV per Unit and Proceeds from Trust Units issued are computed by dividing the value of the net assets by the total number of Trust Units outstanding as at each valuation date. Per Unit data from operations is computed based on the weighted average number of Units outstanding during the period ended December 31, 1999 of 6,429,000 (1998 – 6,473,000). Fully diluted NAV per Unit reflects proceeds and imputed interest net of tax of $17,361,000 in 1999 and 1998 from outstanding options and warrants. Fully diluted data from operations includes imputed interest, net of tax of $71,000 (1998 – $15,000).

4. Management Fees and Administrative Expenses

The Fund Manager receives a management fee (the "Management Fee") which is payable monthly at a rate of 1/12 of 1.35 percent of the average weekly NAV, excluding the greater of i) the portion of the NAV which results from the Fund's investment in the Venture Funds; and ii) the total commitment to the Venture Funds. The Management Fee was $609,000 for the period ended December 31, 1999 (1998 – $307,000).

The Venture Fund Managers charge separate management fees equal to two percent per annum on the amount committed to the Venture Funds, less certain other fees earned by the Venture Fund Managers in connection with the Venture Funds. The Venture Funds' management fees were $255,000 for the period ended December 31, 1999 (1998 – $217,000).

In addition, the Fund Manager is entitled to receive an incentive fee (the "Incentive Fee") from the Fund equal to 20 percent of the excess return provided by the Fund relative to the TSE Oil & Gas Total Return Index (the "Index"), exclusive of the returns generated by the Fund's investment in the Venture Funds, payable quarterly on each record date, commencing December 31, 1998. If quarterly returns of the Fund are below the Index, then the shortfall must be recovered against future excess returns before additional incentive fees are earned. The Incentive Fee was $1,047,000 for the period ended December 31, 1999 (1998 – $823,000).

Accounts payable and accrued liabilities at December 31, 1999 include $93,000 (1998 - $923,000) related to fees payable to the Fund Manager.

5. General and Administrative Expenses

The Fund Manager was reimbursed $178,000 for costs associated with the operation and administration of the Fund during the period ended December 31, 1999 (1998 – $110,000). Accounts payable and accrued liabilities at December 31, 1999 include $34,000 payable to the Fund Manager for these costs (1998 – $54,000).

6. Investments

(thousands)	1999	1998
Investments, at market value, beginning of period	$ 52,555	$ –
Unrealized (gain) loss on investments, beginning of period	4,485	–
Investments at cost, beginning of period	57,040	–
Cost of investments purchased during period, net	29,421	63,005
Cost of investments sold during period:		
Proceeds on sales	(29,415)	(6,157)
Net realized gain on sale	5,663	192
	(23,752)	(5,965)
Investments at cost, end of period	62,709	57,040
Unrealized gain (loss) on investments, end of period	6,102	(4,485)
Investments, at market value, end of period	$ 68,811	$ 52,555

The Venture Fund Managers also have an option which essentially allows them to receive 20 percent of the cumulative realized gains on the assets in the Venture Funds, net of expenses, provided a threshold seven percent annual return is realized by the Fund. There were no amounts realized under the options in 1999 (1998 – NIL), but the accrued value under the options of $696,000 (1998 – NIL) has been deducted from the value of the Fund's portfolio investments, based on December 31, 1999 market values.

7. Credit Facilities

The Fund has a demand credit facility with a Canadian chartered bank up to a maximum of $10,000,000. Borrowings are secured by assets held by the Fund. The facility bears interest at the bank's prime lending rate, has no fixed terms of repayment and is subject to review by the bank at any time. There was $2,810,000 drawn on the facility at December 31, 1999 (1998 – NIL).

The Fund is jointly and severally liable under a demand credit facility with a Canadian chartered bank as part of its investment in Venture Fund 1. Borrowings are secured by assets held in Venture Fund 1. There were no amounts drawn on the facility at December 31, 1999 or 1998.

8. Commitments

The Fund has committed to a total investment of $19,500,000 in Venture Fund 1 and $3,000,000 in Venture Fund 2 to be contributed from time to time upon issuance of drawdown notices from the Venture Fund Managers. As at December 31, 1999, $19,500,000 was contributed to Venture Fund 1 (1998 – $11,895,000) and $450,000 to Venture Fund 2 (1998 – NIL), with the remaining commitment to be called by the Venture Fund 2 manager by October 15, 2002. Investments in the Venture Funds accounted for $22,754,000 of the Fund's net assets at December 31, 1999 (1998 – $10,230,000).

In the event Western Oil Sands Inc. fails to complete an initial public offering prior to March 31, 2000 satisfactory to the terms specified in the original subscription agreement, the Fund is also committed to investing an additional $1,900,000 prior to December 31, 2000.

9. Year 2000 Uncertainty

Most entities depend on computerized systems and therefore are exposed to Year 2000 conversion risk, which, if not properly addressed, could affect an entity's ability to conduct normal business operations. The effects of the Year 2000 issue may be experienced after January 1, 2000. Although the change in date has occurred, it is not possible to conclude that all aspects of the Year 2000 issue affecting the Fund, its investments and those with whom each deals, have been fully resolved.

ARC STRATEGIC Energy Fund

e Information

NATIONAL POLICY STATEMENT NO. 41 – SHAREHOLDER COMMUNICATION PROVIDES BENEFICIAL UNITHOLDERS WITH THE OPPORTUNITY TO ELECT ANNUALLY TO HAVE THEIR NAME ADDED TO THE SUPPLEMENTAL MAILING LIST IN ORDER TO RECEIVE INTERIM FINANCIAL STATEMENTS OF THE FUND. IF YOU ARE INTERESTED IN RECEIVING SUCH STATEMENTS OR OTHER SELECTIVE UNITHOLDER COMMUNICATIONS, PLEASE COMPLETE AND RETURN THIS CARD.

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ARC STRATEGIC
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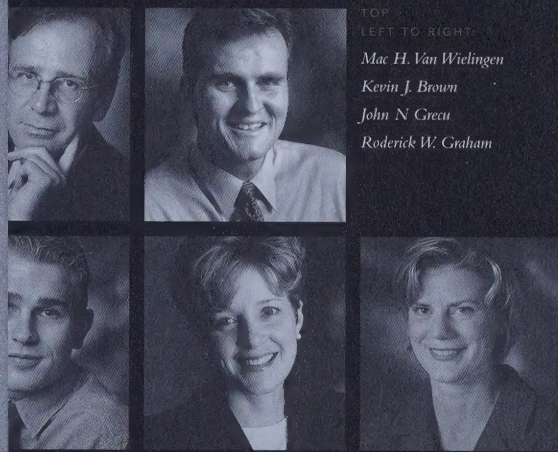

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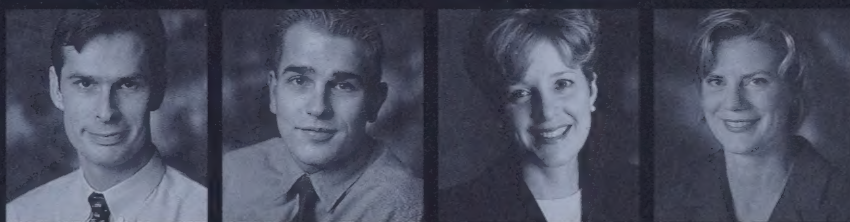

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Trevor S. Houston
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